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SUBJECT: KOREA'S FREE TRADE AGREEMENT WITH ASEAN

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(B) 05 SEOUL 2163

#### Summary

**¶1.** (U) On December 13, 2005, the Republic of Korea and the Association of Southeast Asian Nations (ASEAN) announced the conclusion of a Framework Agreement for a bilateral free trade agreement (FTA). Although the parties had also concluded negotiations for the Trade-in-Goods (TIG) and Dispute Settlement agreements by the time of the December 13 Korea-ASEAN summit in Kuala Lumpur, those agreements were not announced. The TIG announcement is being held up due to Thailand's demand that Korea not be allowed to exclude rice under the agreement; Korea and Thailand are currently in bilateral talks to resolve this issue. The Dispute Settlement Mechanism agreement announcement is being held back until the TIG is fully completed and announced.

**¶2.** (SBU) The ASEAN-Korea FTA (AKFTA), when completed, will be a collection of stand alone agreements, rather than a single unified pact. It is being negotiated and implemented in stages. The agreement also provides for differential treatment between ASEAN's more developed and less developed members. It provides for long staging periods, with full liberalization by ASEAN's less developed members not being reached until 2026 -- 20 years after the expected conclusion of negotiations.

**¶3.** (SBU) The Framework Agreement sets the stage for Korea and ASEAN to announce the subsequent TIG and Dispute Settlement Mechanism agreements in the first half of 2006. Negotiations of the Services and Investment agreements are scheduled to conclude by the end of 2006. If successful, the ASEAN-Korea FTA (AKFTA) would be Korea's second FTA with a multi-national organization, following its FTA with the European Free Trade Association. The Korean government is interested in concluding an FTA with ASEAN because of its strong economic ties to Southeast Asia and support for ASEAN-Plus-Three, as well as out of a sense of competition with China and Japan, which also have (in the case of China) or are negotiating FTA's with ASEAN. The ASEAN-Korea pact will allow for preferential treatment for products manufactured in the Kaesong Industrial Complex (KIC) in North Korea. End Summary.

#### Korea and ASEAN Approve FTA Framework Agreement

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**¶4.** (SBU) Econoff met with Korean Ministry of Foreign Affairs and Trade (MOFAT) FTA Coordination Division Deputy Director Ryu Ho-kwon, Embassy of Singapore Diplomatic Chief of Mission Gabriel Liow, and Embassy of Thailand First

Secretary Bhavivarn Noraphallop in January 2006 to discuss

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the ASEAN-Korea FTA.

15. (SBU) Ryu and Liow confirmed that Korea and ASEAN concluded a Framework Agreement, Dispute Settlement Mechanism and TIG Agreement for the FTA at the December 2005 ASEAN-Korea Summit. The Framework Agreement and Dispute Settlement Mechanism were signed by all countries, but only the Framework Agreement was publicly announced at the Summit. The ASEAN-Korea FTA Working Group will also withhold announcing the Dispute Settlement Mechanism until the TIG Agreement is announced. Although the TIG Agreement was signed by Korea and all ASEAN countries except Thailand, to TIG exclusions list must be finalized according to tariff line and staging times for initially-excluded products. The Framework Agreement specifies that Korea and each ASEAN country may choose specific items to exclude from tariff reductions, provided that the total trade items on the exclusion list does not exceed three percent of the total trade volume or tariff lines.

Kaesong Goods Considered "Made in Korea"

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16. (SBU) Korea scored a diplomatic victory when it persuaded ASEAN to accord goods produced in the Kaesong Industrial Complex the same treatment as good produced in South Korea under the Rules of Origin provisions of the TIG. The Kaesong Industrial Complex is an industrial park located in North Korea where South Korean firms use North Korean labor, and pay the North Korean government a fixed wage per laborer per day. It is considered by Seoul to be a showcase of its economic engagement policy with the North. Accordingly, Korea has requested FTA treatment for Kaesong products in all its FTA negotiations (save Chile, for which negotiations

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were completed before Kaesong was established).

17. (SBU) According to Korean press reports, several ASEAN members were initially reluctant to grant Kaesong goods preferential treatment due to concern about competing with its low North Korean wages. The news that ASEAN did end up agreeing to grant FTA treatment to Kaesong goods therefore met with prominent press coverage here.

ASEAN and Korea Agree to Implement FTA in Stages

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18. (SBU) Liow emphasized that ASEAN and Korea will implement key aspects of the FTA in stages -- but ahead of China and Japan, which are also currently negotiating FTA's with ASEAN. Both the China-ASEAN FTA and Japan-ASEAN FTA will likely go into effect in 2010, while Korea wants to implement the first stage of its FTA with ASEAN by 2009. Ryu explained that implementing the FTA in stages will give all countries time to prepare for tariff reductions. Liow suggested that bragging rights is a major factor driving the Koreans to push for an earlier implementation date. He also claimed that Korea preferred to initially address more difficult FTA issues, namely goods, before services, in order to ensure that the FTA will be implemented.

19. (SBU) Under the TIG Agreement, Korea and ASEAN's six more-advanced countries (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) would abolish tariffs on 80 percent of traded goods by volume and tariff line by 2009, and 90 percent by 2010. By 2016, tariffs on the remaining 10 percent of traded goods initially excluded in the TIG Agreement will be decreased or eliminated. ASEAN's less developed members (Cambodia, Laos, Myanmar, and Vietnam) would abolish tariffs on 80 percent of traded goods by volume and tariff line by 2017, and 90 percent by 2018. By 2026, tariffs on the remaining 10 percent of traded goods initially excluded will be decreased or eliminated. MOFAT anticipates that the liberalization schedule for services

and investment will correspond closely with the TIG tariff reduction schedule. By 2026, tariffs on 97 percent of all ASEAN-Korea trade by volume and tariff line should be eliminated.

¶10. (SBU) On February 3, 2006, ASEAN and MOFAT negotiators met at the 10th ASEAN-Korea Summit in Jakarta, Indonesia to finalize the TIG exclusions list and tariff reduction schedule. Negotiators also commenced negotiations on separate services and investment agreements, which will continue concurrently through 2006. MOFAT and Thai negotiators also met bilaterally to resolve differences over the rice tariff, paving the way for Thailand to sign the TIG Agreement. Pending the outcome of these negotiations, ASEAN and Korea plan to implement all AKFTA agreements by early ¶2007.

#### Rice Issue Hinders Trade-in-Goods Agreement

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¶11. (SBU) During the December 2005 AKFTA Summit, Thailand -- one of the world's top rice producers -- opted not to sign the TIG Agreement after Korea refused to open its rice market. At the time, Thailand believed it could delay the TIG Agreement unless Korea agreed to accept rice concessions. However, because the "ASEAN minus X principle" allows other ASEAN members to sign the agreement over Thailand's objection, Thailand must bilaterally negotiate rice concessions with Korea. According to Liow, Thailand will press for derivative concessions rather than a rice tariff reduction. He said that Thailand will ask Korea to waive the tender process for rice and contribute up to USD 60 million to Thai development.

¶12. (SBU) In 2004, under Annex 5 of the Agriculture Agreement, the WTO ruled that Korea's rice quota could continue for up to ten more years, but only after individual WTO members had the opportunity to negotiate rice concessions with Korea. Ryu and Liow stated that because Korea formally adopted the agreement in December 2005 to expand the quota on imported rice, Korea will probably not agree to any additional change in its rice quota, tariff, or offer rice concessions to entice Thailand to sign the TIG Agreement. Liow added that Thailand will likely sign the TIG Agreement regardless of the outcome of the rice negotiations. Other concessions are possible. Thai Embassy officer Noraphallop admitted that Thailand would be willing to consider other concessions from Korea in lieu of rice, citing Thai fruit as a possible alternative.

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¶13. (SBU) Korean and ASEAN officials are optimistic that the TIG Agreement will be signed by Thailand and that the TIG exclusions list will be finalized by April 2006. Thailand, however, estimates that it may take up to six months before it signs the TIG Agreement. The Korean government hopes to take the necessary steps to ratify and implement the AKFTA Framework Agreement, TIG Agreement, and the Dispute Settlement Mechanism by July 1, 2006.

#### Singapore Supports Multiple FTAs with Korea

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¶14. (SBU) Singapore is in a unique position in that it already finalized a bilateral FTA with Korea, set to enter into force on March 2, 2006. Nevertheless, Singapore strongly supports the AKFTA because it gives the small nation additional economies of scale, and Singapore has not agreed to any additional concessions under AKFTA. Singapore hopes that ASEAN's FTAs with Korea, China, and Japan will lay the foundation for greater cooperation through the East Asia Summit.

#### Comment

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¶15. (SBU) The main "innovation" of the AKFTA is the decision to negotiate and implement the pact in stages, broken up

into separate agreements: TIG, Dispute Settlement, Services, Investment. The long staging periods (until 2026) for a relatively large segment of trade volume is striking, and could be problematic for future negotiations if Korean officials and domestic interest groups come to view this approach as a precedent to be applied in future agreements. The granting of FTA Rules of Origin treatment to goods produced in the Kaesong Industrial Complex located in North Korea gives Korea a consistent record of achieving this demand in its FTA negotiations, thus far, and could whet its negotiators' appetites -- and affect public expectations -- for a repeat in future FTA's.

VERSHBOW